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IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-279

HARRY S. STONEHILL; ROBERT P. BROOKS,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

REPLY TO BRIEF IN OPPOSITION

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INTRODUCTION

The government's brief seeks to convey an image of the Petitioners as disinterested participants in this proceeding which began almost thirty-one years ago. The image which the government has now conjured up depicts Petitioners as shareholders with no rights regardless of how the government chooses to dispose of their last remaining assets. According to the government, the District Court's decision, which directs the Petitioners and Pine Street Corporation to dismiss the litigation against Tiburon, cannot be a denial of due process because the "Petitioners have no valid personal claims against Tiburon", and because "the due process clause does not entitle a person to conduct discovery on a claim that is foreclosed as a matter of law." (Opp. at 6) Without proffering any legal support for this contention, the government hopes thus to convince this Court

that this is hardly a case in which due process protection for taxpayers, who are "mere shareholders" in a corporation controlled by a Receivership, need be proclaimed. This image, however, is as false as it is irrelevant.

The law affords a shareholder standing to make a constitutional challenge for violation of due process rights where as in the instant case, the shareholder suffers a devaluation of stock and is deprived of property without due process of law. *See e.g. Beerly v. Department of Treasury,* 768 F.2d 942, 948 (7th Cir. 1995) (Shareholder granted standing to raise constitutional challenge on due process grounds based on deprivation of property, *i.e.,* devaluation of stock, because of allegedly unreasonable valuation procedure.) The Petitioners did not concede, as suggested by the government, or as found by the Court of Appeals, that they were not "entitled to collect damages from Tiburon for the decrease in property value caused by the allegedly improper zoning." (App. A at 7a). Before the Court of Appeals, the Petitioners conceded *only* that individual corporate shareholders "as a general principle" cannot sue a third-party wrongdoer for injuries to the corporate entity because "corporate injuries necessarily result in diminished corporate value, which in turn causes all shareholders to suffer a common harm, *i.e.,* a decrease in the value of their stock."[1] Appellants' Reply Brief at 1. The devaluation of Pine Street Corporation's remaining assets, the proceeds of which are required to be directly applied against Petitioners' tax liability, constitutes an injury to the Petitioners, who, along with their former wives, are the sole shareholders of the corporation.

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[1] Before the Court of Appeals, Petitioners argued that they fell within the exception to this general rule because they have suffered a separate and distinct injury arising from the compounded accrual of interest on their tax liability.

Petitioners' claim of a denial of due process is not dependent upon their right to pursue a direct cause of action in litigation against Tiburon. The interested and named parties in the litigation against Tiburon, are both the corporate entities and the Petitioners, designated by the Receiver as the shareholders of these entities who, as such, "have a beneficial interest in the property." The state court litigation was brought at the request of the Petitioners as shareholders, with the approval of the Receiver, the government and the District Court. Regardless of whether the Petitioners could have brought a direct action, they would be entitled as sole shareholders, to bring a derivative cause of action if the corporation or the Receiver had refused to do so. And, it is axiomatic that "every suit in a derivative capacity necessarily includes a suit in an individual capacity as well." *May v. Midwest Refining Co.*, 121 F.2d 431 (4th Cir. 1941) (quoting Col. Law Rev., 405, 416 n.78).

Summary dismissal of the state court litigation (without any consideration) by both the Petitioners *and* the corporation is required by the District Court in the Receivership proceeding, not by the state court where the litigation against Tiburon was brought. Although the state court also ordered dismissal of the litigation prior to discovery, the California Court of Appeal reversed that decision and remanded the Petitioners' cause of action of unlawful precondemnation downzoning to the trial court. The Court of Appeal held that it would not "speculate on the facts, if any, the Plaintiffs will be able to produce to support allegations in this cause of action." The District Court's decision, reached without allowing the Petitioners the right to conduct discovery, deprives the Petitioners of their property without the procedural safeguard of due process.

A. As Sole Shareholders, The Petitioners Have Suffered Injuries Caused By The Decrease In The Value Of The Property

The Court of Appeals' decision that the Petitioners do not have a direct cause of action against Tiburon and that any claim of consequential damages is incidental to the injury caused to the corporation, does not mean, as argued by the government, that Petitioners have not been injured and are not entitled to due process protections in the Receivership proceeding.

The general rule that a shareholder cannot bring a direct cause of action for a third-party injury to the corporation is grounded on several policy reasons. First, a contrary rule would authorize suits by each shareholder and result in a multiplicity of suits against the wrongdoer and ignore the corporate entity. *Sutter v. General Petroleum Corporation,* 28 Cal.2d 525, 170 P.2d 898 (Cal. 1946). Second, the rule is necessary so that damages recovered by the corporation may be available for payment of the corporation's creditors. *Martin v. Maldonado,* 572 P.2d 763, 773 n.34 (Alaska 1977). Lastly, permitting individual recovery could have the effect of removing from the board of directors its prerogative to use the recovered damages for any legitimate business purpose. *Commonwealth of Massachusetts v. Davis,* 140 Tex. 398, 168 S.W.2d 216, 221 (Tex. 1943).

These reasons, however, have no bearing on the issue in this case of whether the Petitioners have suffered injury or have been deprived of property by the actions of Tiburon. Petitioners and their wives are the sole shareholders of the corporation which owns the Tiburon Property. Thus, there can be no multiplicity of lawsuits against Tiburon by other shareholders or the corporate entities which are already named Plaintiffs in the Tiburon litigation. It is also undisputed that the government is

the only creditor entitled to claim the proceeds of the sale of the Tiburon Property or to any damages which are collected in the Tiburon litigation. There are no other corporate creditors involved in the Receivership nor are there any legitimate business purposes for which recovered damages might be used by the corporation or the Receiver.

The Tiburon Property and the litigation against Tiburon are the last remaining assets of the Pine Street Corporation which continues its existence as a corporate entity for the sole purpose of liquidating those assets. All proceeds from the sale of those assets will be applied to reduce the Petitioners' tax liabilities. Thus, even if Petitioners are not entitled to bring a direct cause of action, it does not follow that Petitioners have not suffered injury or have not been deprived of property.

The Court of Appeals' concluded that "the Receivership has valid claims against Tiburon." Its decision that those claims, however, were "speculative at best" was based on the District Court's findings that there were insufficient facts to demonstrate any unlawful precondemnation activity by Tiburon. These decisions, reached without an opportunity for discovery, deprive the Petitioners of their last remaining assets without the essential procedural safeguard of due process.

B. The Petitioners' Right To Due Process Protection Is Not Dependant On Their Right To Directly Sue Tiburon

As sole shareholders, any recovery by Pine Street in the Tiburon litigation, which will be applied to reduce Petitioners' tax liabilities, would compensate the Petitioners in their capacity as shareholders. Thus, the "so-called" settlement of the litigation against Tiburon, without any consideration, will deprive the Petitioners of property regardless of their ability to bring a

direct cause of action. The government argues that the Petitioners, however, have no right to conduct discovery [2] with respect to the claims of the Pine Street Corporation, because "the Receiver, not Petitioners, had exclusive control over the stock of the Pine Street Corporation and was authorized to manage and conserve the assets of the corporation pending sale of the assets and foreclosure." (Opp. at 7) (Citing *Loeb v. Berman*, 20 P.2d 685, 686 (Cal. 1933))

Unlike *Loeb*, however, the Receiver in this case has not been substituted as the Plaintiff for the corporation in the state court proceeding.[3] The Receiver, further, instituted the litigation against Tiburon on behalf of the corporation and the Petitioners as beneficial owners of the property at the Petitioners' request and with the approval of the court. If the Receiver had refused to bring the suit or "where it would be a vain thing to make a demand upon [it], and it is shown there is a necessity

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[2] The government incorrectly states that Petitioners' due process objection that "additional discovery" was required was first raised as a separate issue in the Petition for Rehearing in the Court of Appeals. The Petitioners claim was not that *additional* discovery was needed but that *no* discovery had been allowed by the District Court (Appellants' Brief at 20, 21) and that the District Courts action "clearly violates the Appellants' constitutional rights to due process and access to the Court." (Appellants' Brief at 11) In its Petition for Rehearing, Petitioners further argued that the Court of Appeals decision that the Pine Street cause of action, although valid, was speculative, was in conflict with a decision of the Court of Appeals issued shortly before oral argument. That decision held that property owners alleging violation of equal protection rights, (as are alleged in Petitioners claim against Tiburon) arising from the use of a city's regulatory powers to deflate the value of a Plaintiffs' property which it wants to acquire, was a fact question precluding summary judgment. *Armendariz v. Penman*, 75 F.3d 1311 (9th Cir. 1996)

[3] In the state court litigation, the Town of Tiburon filed a motion to compel the joinder of the Receiver as a necessary party, "as the person possessing 'exclusive control, custody and possession' of the subject property" because "the town and Plaintiffs would not be able to settle this action without the Receiver's participation." The Receiver, however, was not subsequently added as a Plaintiff.

for a suit for the protection of the interest of creditors", the shareholder is free to sue. *Landy v. FDIC*, 486 F.2d 139, 148 (3d Cir. 1973) (quoting *O'Connor, et al. v. Rhodes*, 65 App.D.C. 21, 79 F.2d 146 at 149, aff'd sub nom. *United States Shipping Board Merchant Fleet Corp. v. Rhodes*, 297 U.S. 383, 56 S.Ct. 517, 80 L.Ed 733 (1936). This is especially true where, as in this case, the Receiver is hostile to the claims asserted by the Plaintiff and is objecting not only to the shareholders right to sue, but as well against the validity of the claim. *Id.* at 148.

Prior to his appointment as Receiver, Mr. Collette's law firm was retained by the original Receiver to represent the Receivership in the efforts to obtain favorable zoning for the Tiburon Property. After receiving considerable monies in legal fees as counsel to the Receivership, and following his appointment as Receiver, Mr. Collette's firm was initially involved in the preparation of the second complaint filed against Tiburon. Subsequently, however, Mr. Collette as Receiver, recommended that the property should be sold to the city of Tiburon for the appraisal price.[4] He further recommended that the litigation be withdrawn because the claims against Tiburon, which had thus far involved the expenditure of over 2.5 Million dollars in Receivership funds, were speculative.

In cases such as this, where the Receiver is hostile to the claims asserted by the Plaintiff shareholder in a suit and argues

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[4] The litigation against Tiburon, does not prevent the sale of the property, which has not been publicly marketed during the many years the Receivership has attempted to obtain zoning approval from Tiburon. Dismissal of the litigation against Tiburon is *only* a requirement if the property is sold to the very entity responsible for its currently depressed value.

not only against the shareholders right to sue but against the validity of the claims, "the rule of the exclusive power in the Receivership is not absolute. To admit of no exception would be to sacrifice substantial rights to matters of form. That is not a purpose for which courts are constituted." *See id.* at 149 (quoting *Brinckerhoff v. Bostwick,* 88 N.Y. 52, 59.

CONCLUSION

At stake is whether the government can deprive a taxpayer of property by denying any opportunity for discovery prior to summary dismissal of the taxpayers litigation claims, on the grounds that these claims are speculative, without any consideration and without any credit given against the taxpayers' liabilities. This issue, which involves one of the most fundamental procedural safeguards of due process, clearly merits this Court's plenary attention.

Respectfully submitted,

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